

A social club whose active members pay substantially lower dues and initiation fees than associate members, although both classes enjoy the rights and privileges in the club facilities, does not qualify for exemption under section 501(c)(7) of the Code.

Advice has been requested whether the club described below qualifies for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

The club was organized as a nonprofit organization for the purpose of promoting social enjoyment among its members. The club has two classes of members, active and associate. Only members of a particular profession are eligible for active membership. Associate membership is open to persons whose profession, business, or activity brings them into close relationship with active members. Each associate member must be sponsored by an active member and subsequently approved by the board of governors. Associate members outnumber active members approximately four to one. Only active members have voting rights in the control of the club. Active members pay substantially lower dues and initiation fees than associate members although both classes of members enjoy the same rights and privileges in the club facilities.

Section 501(c)(7) of the Code provides that clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from Federal income tax, provided no part of their net earnings inures to the benefit of any private shareholder.

Net earnings of a club may inure to members in such forms as an increase in services offered by the club without a corresponding increase in dues or other fees paid for club support. Rev. Rul. 58-589, C.B. 1958-2, 266. The facts in this case show that the active members received the same club benefits as associate members, although they pay a lesser share of operating expenses. In effect, the active members are being subsidized at the expense of the associate members, which constitutes inurement of income.

Accordingly, it is held that this club is not exempt from Federal income tax under section 501(c)(7) of the Code.